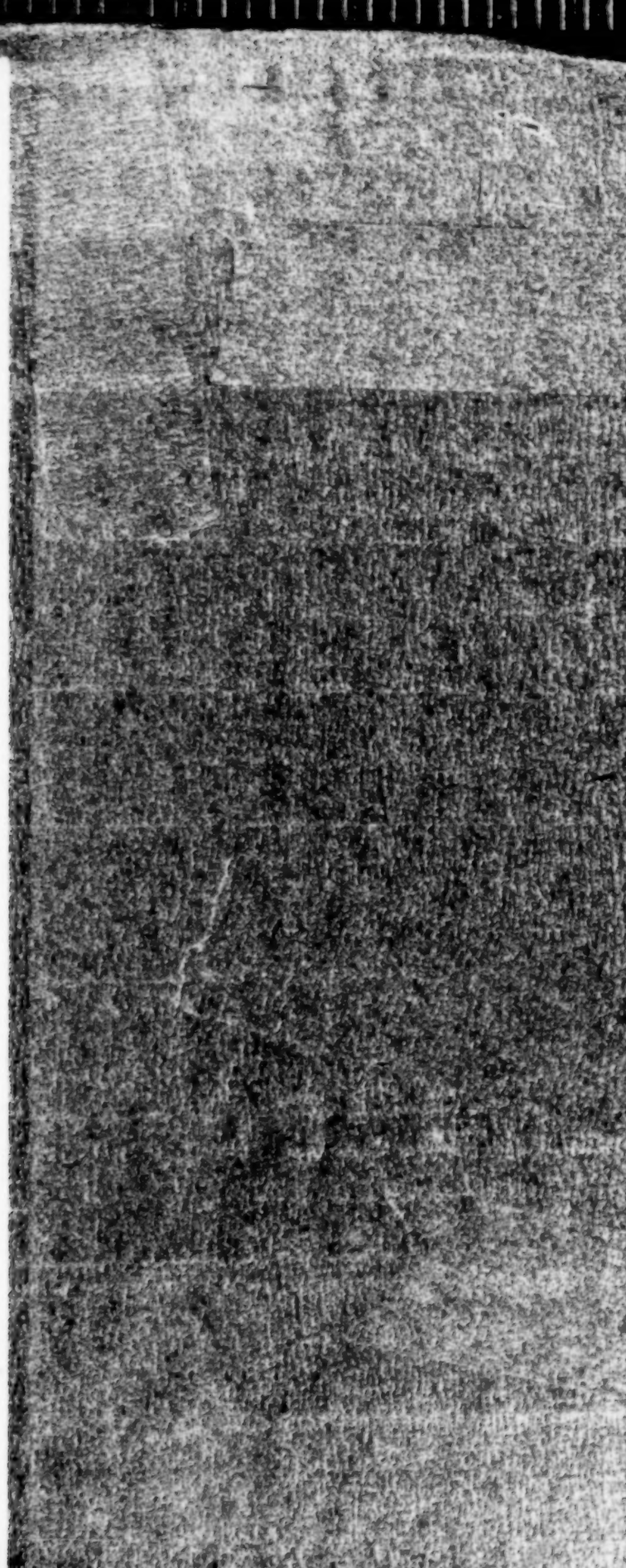

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 77-1652

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,

v.

SHELL OIL CO., ET AL.,
Respondents.

No. 77-1654

CONSUMER ENERGY COUNCIL OF AMERICA,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

ON WRITS OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY BRIEF OF PETITIONER CONSUMER ENERGY COUNCIL OF AMERICA

In response to the challenge of Consumer Energy Council of America ("Council") to Order 539-B's prudent operator standard, the Federal Energy Regulatory Commission ("Commission") does not dis-

pute our claim that the Natural Gas Act ("Act"), on its face and as interpreted by this Court, is centrally concerned with the maintenance of steady and reliable service. Nevertheless, the Commission fails to explain how the prudent operator standard in fact reflects the Act's service concern or, indeed, why this standard never looks to past service in giving substance to the producers' obligations. Nor does the Commission seek to justify Order 539-B's failure to draw upon the express provisions of § 4(d) or § 7(b) of the Act, 15 U.S.C. § 717c(d) and § 717f(b), pursuant to which the burden is on the producer to explain and obtain approval for reductions in service. */

Rather, the Commission defends its position along essentially three lines. First, it claims in conclusory fashion that Order 539-B is due great deference by this Court, and is thus essentially beyond challenge by the Council. Second, it finds support for the reasonableness of its position in the fact that it has now tied the prudent operator standard directly to the laws of the applicable producing state. And third, it criticizes the Council for not being more specific

*/ Cf. Sunray Mid-Continent Oil Co. v. FPC, 364 U.S. 137, 141, 156, (1960). Reliance on such procedures was also a central element of the Commission's initial Order 539. R. 147-58.

in articulating a proper standard governing service. */ As indicated below, principles of deference do not place Order 539-B beyond challenge; the Commission's effort to avoid conflict with state law by incorporating it wholesale further undercuts the standard's validity; and, finally, little effort is needed to flesh out the service concept the Council advances.

*/ The Commission also suggests that the Council's challenge to the prudent operator standard is not appropriate for judicial consideration at this time, since that issue was not ruled on by the Court of Appeals. We assume that the Court has, by granting certiorari, already provided its own answer to this suggestion. In any event, sound reason resides in review disposing of this entire litigation, because (1) a substantial period of time has already been consumed on appeal; (2) the Commission's efforts in this area will continue to be in a state of limbo until final resolution of all the issues; (3) the terms of the Natural Gas Policy Act of 1978 (Pub. L. No. 95-621)("NGPA") make prompt resolution all the more important (see Brief of Petitioner Consumer Energy Council of America ("Council Brief") at 18-23); and (4) the question is one purely of law, and has been fully briefed in this Court. See Permian Basin Area Rate Cases, 390 U.S. 747, 823-24 (1968); see also New Motor Vehicle Board v. Orrin

(footnote continued)

For their part, the producers properly pose the issue: whether the Commission or the producer is the appropriate party to assess the reasonableness of declining deliveries. But they propose the wrong answer. In the process, they attempt to read producer service jurisdiction out of the Act altogether. They also seek to bolster their contentions by mischaracterizing the Council's position, which does not argue for a warranty arrangement ignoring the technical and geological reality in the field, but simply seeks a mechanism assuring Commission oversight and approval of declining deliveries. Finally, the producers raise the specter of Commission orders directing "the producer as to how, when and where his capital is to be invested to produce the gas reservoir most efficiently." Brief of Respondent Producers ("Shell Brief") at 14. Whatever might be contemplated by the Commission's prudent operator standard, this would not be the case under an appropriate service standard. That is not to say, however, that producers can avoid their obligations under the Act by merely asserting that expenditures may have to be made in order to meet their service obligations.

(footnote continued)
W. Fox Co., 47 U.S.L.W. 4017, 4021 n. 13 (Dec. 5, 1978); FPC v. Sunray DX Oil Co., 391 U.S. 9, 45-46 n. 35 (1968).

I. THE PRUDENT OPERATOR STANDARD CANNOT WITHSTAND APPROPRIATE REVIEW

A. The Commission's Prudent Operator Standard Is Not Due Substantial Deference

The Commission contends that, because it is the agency charged with enforcing the provisions of the Natural Gas Act, its interpretation of producer delivery obligations is essentially beyond challenge. Memorandum for the Federal Energy Regulatory Commission as Respondent ("FERC Mem.") at 4-6. In short, the Commission asks for blind acceptance of the standard, without supplying any explanation of why the formulation is a reasonable one. Moreover, the Commission seeks this protected status for Order 539-B without so much as hinting why the Order should obtain more favored review from the Court than any other order under the Natural Gas Act. In the process, the Commission provides both an incomplete and misleading characterization of the Court's decisions relating to the degree of deference accorded an administrative agency's construction of statutory terms.

This Court has held that an order of the Commission, to be upheld, must fall within a "zone of reasonableness." Permian Basin Area Rate Cases, 390 U.S. at 767. To satisfy this standard, three distinct tests must be met. The order

must be: (1) consistent with statutory authority; (2) supported by substantial evidence; */ and (3) reflective of a proper balance between the interests of the industry and consumers.**/ Id. at 791-92. In conducting this examination, however, the scope of review and the deference to be shown the agency's decision will vary substantially depending upon the particular test involved. Thus, under the second -- substantial evidence -- test, special deference may be due to "legislative" or "policy" rules. See 1 K. Davis, Administrative Law Treatise, §§ 5.03, 5.05-5.07 (1958). However, under the first -- statutory

*/ Permian Basin, and rate cases generally, represent the prototypical deference situation. There, a reviewing court is faced with an agency long-experienced in the rate-setting process, analyzing a host of concrete factual factors, in formulating a forward-looking policy determination. As indicated below, this is not the situation presented here.

**/ By relying on a concept which so heavily reflects producer profitability, the Commission also fails to strike the proper balance under the third test. See discussion at pp. 12-15, infra.

interpretation -- test, the scope of review is much stricter. This Court has said repeatedly that "the interpretation of the meaning of statutes . . . is exclusively a judicial function," United States v. American Trucking Associations, 310 U.S. 534, 544 (1940), in which the court retains the final word as to the propriety of the administrative construction. See SEC v. Sloan, 436 U.S. 103, 117-18 (1978); Batterton v. Francis, 432 U.S. 416, 424 and 425-6 n. 9 (1977); NLRB v. Enterprises Association of Pipefitters Local 638, 429 U.S. 507, 522 n. 9 (1977). */

The Commission itself has characterized Order 539-B as an exercise in statutory interpretation, **/ and cor-

*/ The Commission has relied on Niagara Mohawk Power Corp. v. FPC, 379 F.2d 153 (D.C. Cir. 1967) and FCC v. National Citizens Committee for Broadcasting, 436 U.S. 775 (1978), among others, to bolster its claim of deference. FERC Mem. at 4-6. However, in so doing, the Commission has confused the respective scopes of review under the first and second test of the zone of reasonableness standard. The cases cited refer to the deference due a "legislative" or "policy" judgment of the agency, and are of minimal relevance to issues of statutory interpretation.

**/ Brief for the Federal Energy Regulatory Commission ("FERC Initial Brief") at 34; FERC Mem. at 4.

rectly so. Thus, a more searching scope of review should be applied, involving an independent determination of whether the Commission's construction is consistent with the language, legislative history and purpose of the Natural Gas Act. See SEC v. Sloan, 436 U.S. 103; United States v. Larionoff, 431 U.S. 864, 873 n. 12 (1977); see also FPC v. Texaco, Inc., 417 U.S. 380 (1974); Morton v. Ruiz, 415 U.S. 199 (1974).

By the above analysis, we do not mean to suggest that no deference may be paid an agency's interpretation of its statute. But even the more modest deference given statutory interpretation depends upon the presence of certain factors. Batterton v. Francis, 432 U.S. at 425-26 n. 9; Skidmore v. Swift & Co., 323 U.S. 132, 139-40 (1944); Davis, supra § 5.11. Primarily, deference may be shown when administrative interpretations are longstanding, consistent, or draw upon special experience. See Red Lion Broadcasting Co. v. FCC, 395 U.S. 367, 381-82 (1968); United States v. Healey, 160 U.S. 136, 145 (1895). But see Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672, 677-78 (1954), where this Court declined to adopt the Commission's interpretation of the Natural Gas Act, as it related to producers; and SEC v. Sloan, 436 U.S. at 117-19.

Order 539-B, however, represents the Commission's first effort to interpret the extent of producer delivery obligations, in a changed supply situation of recent origin. This may explain

why, since the development of the standard was initially undertaken, the form has twice changed radically -- from Order 539 to 539-A, to 539-B. In any event, the interpretation cannot be termed either consistent or longstanding. Also, it should be noted that, at the time of the proceedings in question, a number of the Commissioners were newcomers to the agency, and had little experience in natural gas regulation. */ In addition, most of the more experienced members of the Commission's staff in this area had been recently transferred and replaced with inexperienced personnel. **/ Taken together, these factors demonstrate that the Commission did not possess a "more specialized experience . . . than is likely to come to a judge in a particular case." Skidmore v. Swift & Co., 323 U.S. at 139. Finally, Order 539-B fails to demonstrate the thoroughness of analysis and reasoning which could entitle it to particular deference. In formulating the prudent operator standard, the Commission simply adopted state law concepts because of their familiar-

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*/ Subcomm. on Oversight and Investigations of the Comm. on Interstate and Foreign Commerce, 95th Cong., 1st Sess., Report on Adverse Personnel Actions Against Professional Staff Members at the Federal Power Commission at 2 (Comm. Print 1977).

**/ Id. at 13.

ity to producers, not because, through application of its accumulated expertise, it had developed a finely tailored approach to give form to the Act's service obligations. Council Brief at 42-43.

B. The Prudent Operator Standard Is In Conflict With The Provisions Of The Act Designed To Assure Reliable Service

As indicated above, the basic dispute between the Council and the Commission concerns the proper interpretation of the Natural Gas Act. We do not argue, as the Commission states (FERC Mem. at 3), that the Act might be more effectively implemented through a somewhat different rule; rather, we contend that the prudent operator standard is fundamentally at odds with the Natural Gas Act, which was intended to assure that service be continued unless and until the Commission should find a change or abandonment of service to be in the public interest. */

We showed in our initial brief that the Commission's standard, drawn from state law, could not be relied upon to provide consumers of dedicated gas reliable service. In trying to ward off the producers' contention that the federal standard will conflict with state regulation, the Commission has "clarified" its position by stating that the federal standard will not just be drawn from

*/ We also argue the standard is vague and unenforceable. Council Brief at 43-50.

state law, but will indeed be identical to state law. */ But if the various state laws which the Commission, in a leap of blind faith, embraces as the federal standard on any occasion further the ends of the Act, it will be by coincidence only. Moreover, the adoption of these laws violates a cardinal principle underlying the Act, which was designed to establish a comprehensive federal regulatory scheme in place of a patchwork of state regulations.

1. Conservation Law. As indicated in our initial brief, laws relating to conservation cannot provide the basis for an adequate service standard. The simple reason for this is that conservation laws are aimed at preventing waste, and there is no need to assure minimum production or service levels in order to achieve that end. Council Brief at 41. **/

*/ The Commission states that its standard will not impose obligations different than those under state law, but will simply require "that the producer operate in accordance with established practice and with requirements adopted by the jurisdiction exercising direct regulation over the production." FERC Initial Brief at 32. (Emphasis added.)

**/ This fact has a direct bearing on the producers' claim that jurisdiction is precluded because there is no regulatory gap. See e.g., Brief of Respondent Tenneco Oil Company and Pennzoil Company ("Tenneco/Pennzoil Brief") at 19-23.

Moreover, while we, no less than the Commission and the producers, fully support state conservation principles, it is neither necessary nor appropriate to use state conservation laws as the federal standard in order to avoid conflict. The Commission's regulations dealing with abandonment already accommodate state conservation standards, */ as does the Commission's definition of deliverability, quoted in our original brief (Council Brief at 15-16 n. 19). In the same manner, a proper service standard, although independent of state conservation laws, could be expected to take those laws into consideration.

2. The Law Governing The Producers' Lease. The validity of the prudent operator standard, then, must ultimately be determined by reference to the laws governing the producer's lease. However, as demonstrated in our initial brief, that body of law is infused with considerations of profitability, **/ and is

*/ The Commission's regulations dealing with abandonment provide that "nothing herein shall be construed as interfering or as intended to interfere with or to prevent compliance by a natural-gas company with valid conservation orders of a State agency relating to the production or gathering of natural gas." 18 C.F.R. § 157.30(a)

**/ See e.g., E. Brown, Law of Oil and Gas Leases, § 16.05 at 16-151 (2d ed.
(footnote continued)

thus ill-suited to achieving the purposes of the Act. Council Brief at 39-41. The Commission has not shown otherwise. */ The producers, however, contend that under their leases they must produce gas expeditiously because "(i) other lessees on adjoining leases in the same reservoir will deplete the reservoir from their wells; (ii) the lessor will insist on speedy and maximum production," in order to protect his interests. Shell Brief at 26. The

(footnote continued)
1973): "[T]here have been hundreds of decisions from the courts in practically all of the oil and gas producing states affirming and adopting the principles, as stated in the Brewster case [Brewster v. Lanyon Zinc Co., 140 F. 801 (8th Cir. 1905) cited in our initial brief at 39]," [that] '[i]t is only to the end that oil and gas shall be extracted with benefit or profit to both [the lessee and lessor] that reasonable diligence is required . . .'" (quoting from Clifton v. Koontz, 160 Tex. 82, 325 S.W.2d 684, 695-96 (1959)).

*/ Indeed, in a major investigation into off-shore non-producing reserves, an administrative judge of the agency recognized this shortcoming of Order 539-B's prudent operator standard. After alluding to the standard's vagueness as an analytical tool, the judge explained that the standard in private law is designed to further "the private
(footnote continued)

amount of protection the lessor-lesse relationship may provide the interstate consumer is perhaps best illustrated by considering a leading Oklahoma Supreme Court decision on the subject.

In the case of Gazin v. Pan American Petroleum Co., 367 P.2d 1010 (Okla. 1962), cited in H. Williams and C. Meyers, Oil and Gas Law, § 856.3 at 409 (1976), the defendant completed a gas well in 1956 capable of producing in excess of 20 million cubic feet of gas per day, and with an overall potential of approximately 4 billion cubic feet of gas. The well was shut in and no contract for the sale of gas was made until 1960. The court found that there was no drainage of oil or gas from the leased premises. */

(footnote continued)
financial interest of parties to an oil or gas lease," and concluded: "In general, therefore, the Commission's objective [in formulating a standard governing delivery obligations] and the purposes of the common law implied convenant are widely divergent." Initial Decision of Presiding Administrative Law Judge on Investigation of Offshore Dedicated Natural Gas Reserves in the Federal Domain in the Gulf of Mexico, FERC Docket No. RI75-112 at 95 (July 7, 1978).

*/ Drainage only occurs if a different lessee on adjoining premises drills a well into the same reservoir and begins to withdraw gas in excess of his allowable share.

The court also found that the lessee had exercised reasonable diligence in seeking and obtaining a satisfactory market, and that therefore there was no breach of any implied covenant. The court so found despite the fact that the lessee could have sold the gas to a nearby pipeline long before 1960. The lessee had refused to sell the gas in the hope of exacting more favorable contract terms from the pipeline, a hope which was realized at the end of the four year wait.

Similarly, it is clear that the prudent operator standard would not be violated if the producers delayed production in order to secure a more favorable rate for dedicated gas. The same result would obtain if the gas could be diverted for sale at a deregulated price. */ In either case, the ultimate increase in profits would be to the mutual advantage of the lessor and lessee.

*/ The producers have asserted that the Natural Gas Policy Act (NGPA) creates no incentive to shift production from dedicated wells to new wells, because such a shift is physically impossible. Shell Brief at 27 n. 34. The reasons the producers give to support this argument are overly simplistic. For example, the producers claim that state well-spacing requirements will prevent a physical shift

3. The Concept of Reliance on State Law. The Commission's action in drawing the product operator standard

(footnote continued)
from one well to another. Assuming arguendo that this proposition is correct in theory, for a variety of reasons exceptions can be granted to well-spacing requirements. Cases have been found in which the majority of all wells in a field were drilled as a result of "exceptions." 1 M. Myers, The Law of Pooling and Unitization, § 1.01 at 17 (1967). However, a producer would only need to obtain one such exception in order to drain the entire supply of gas from a geologically simple reservoir. See Excerpts from the Report of the Governors' Special Study Committee on the Interstate Oil Compact Concerning the State Conservation Laws, reproduced in 5 W. Summers, Oil and Gas § 1053 at 270 (1966).

Producers also assert that the Commission's power to review state agency determinations allowing gas to qualify for a higher price under the NGPA is adequate to assure that already dedicated gas will not be diverted into higher priced or deregulated categories. Tenneco/Pennzoil Brief at 25-26. This is simply incorrect. While the Commission clearly has authority to assure itself that allegedly new gas actually meets the requirements of NGPA, nothing (footnote continued)

firmly into the orbit of state law also conflicts with a fundamental principle of the Natural Gas Act, i.e. that there be a comprehensive and uniform regulatory scheme. FPC v. Transcontinental Gas Pipe Line Co., 365 U.S. 1, 27-28 (1961). See also California v. Southland Royalty Co., 98 S. Ct. 1955, 1961-62 (1978); FPC v. Louisiana Power & Light Co., 406 U.S. 621, 631, 633-35 (1972); Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672, 691 (1954). A standard such as "prudent operation," which will vary from state to state, */ depending on concepts of local property law and state regulatory practices, will inevitably produce a checkerboard of federal regulation which the Act, as interpreted by this Court, was designed to prevent.

(footnote continued)
therein either allows or requires the Commission to determine that service from old wells is being maintained as a prerequisite to granting new gas status. For example, as long as the new well is the required 2.5 miles distant from, or 1,000 feet deeper than the old well, gas produced from the new well would qualify for the higher price, regardless of whether production from the old well had been curtailed. NGPA § 102(c)(1)(B).

*/ See e.g., Excerpts from the Report of the Governors' Special Study Committee, supra, reproduced in 5 W. Summers, Oil and Gas, § 1053 at 319-400, which provides a comparison of producing state laws.

Finally, there is a contradiction in the Commission's own reasoning. If, as the Commission and Council agree, there is a present need for the Commission to spell out the nature and extent of producer delivery obligations under the Act so as to provide the consumer assured and reliable service, it follows that the need has not been met by already existing state production standards.

C. The Contours Of A Service Standard Are Readily Apparent

The Commission is dissatisfied that we have not formulated a more precise standard for the agency's use. FERC Mem. at 9. This suggestion that we dictate an exact standard to the agency is hardly in keeping with the Commission's repeated claim that deference should be paid to its accumulated expertise. Id. at 4-6. Nevertheless, we have already suggested the contours of a standard consistent with the Act. See Council Brief at 48-49. The goal is clear: to require producers to justify declines from past service. For administrative ease, the Commission might want to utilize a profile drawn to reflect the production over time of a typical field, with leeway built in to provide for automatic approval of declines within a certain range of the norm. See related discussion of producer obligations at pp. 27-29, infra. Within these broad parameters, it is the Commission, not the consumer that should give real content

to a rule governing declining service. */ Our legal argument is not premised on a contention that the Council is able to develop a better mechanism than the Commission could. Our argumemt is that the Commission's standard is contrary to the law. That contention stands on its own merits.

II. THE PRODUCERS FAIL TO OFFER VALID OBJECTIONS TO PROPER REGULATION OF SERVICE OBLIGATIONS

A. The Producer Challenge To Commission Jurisdiction Seeks To Rewrite The Natural Gas Act

On the threshhold jurisdictional question, the producers seek to ignore both the purpose and the express terms of the Act. Shell has essentially asserted that no delivery standard would be jurisdictional, since implementation would involve the Commission, at least incidentally, in some aspect of production activity. Shell Brief at 21. Tenneco and Pennzoil somewhat more generously acknowledge that the Commission "has full authority to compel producers to sell in interstate commerce gas which is produced from dedicated acreage." Tenneco/Pennzoil Brief at 15.

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*/ In performing this task, the Commission may find valuable assistance in the analysis provided by Amici Curiae United States Council of Mayors, et al. in their brief in this proceeding.

However, they maintain that no jurisdiction attaches to service obligations if the producer chooses not to produce at all. Id. */

We believe these points have been adequately anticipated in our brief and that of the Commission. Council Brief at 50-59; FERC Brief at 23-30. Now that the producers' exact positions have been made clear, however, two comments seem appropriate. First, the producers' reading would necessarily render the carefully crafted abandonment provisions of § 7(b) of the Act a nullity. Under their view, the Commission would have no recourse if it denied a producer's request to abandon, but the producer nevertheless chose to close down production. A Commission order thereafter seeking to enforce the denial of abandonment would, by their reading, be beyond the Commission's jurisdiction.

But the basic problem with the producers' jurisdictional argument is that it ignores the purpose of the Act, and the purpose of the exemption. We fully agree with the Commission that a reasoned interpretation of § 1(b) cannot be so "mechanistic," but must reflect a functional approach FERC Initial Brief at 29. In determining the scope of

*/ For support, the producers rely almost exclusively on pre-Phillips decisions, and of course, no decisions which deal with service and supply under the Act.

federal authority over pipelines in Illinois Gas Co. v. Central Illinois Public Service Co., 314 U.S. 498 (1942), this Court rejected just such a "mechanistic" formulation. In that case, the Court stated: "[T]he Court, in determining the validity of state regulations, has been less concerned to find a point in time and space" where federal authority ends and state authority begins, "and has looked to the nature of the state regulation involved, the objective of the state, and the effect of the regulation upon the national interest. . . ." Id. at 505.

A similar approach was followed in United Gas Pipe Line Co. v. FPC, 385 U.S. 83, 89-90 (1966), where the Commission's authority to require a pipeline to purchase natural gas in order to end a de facto abandonment was upheld, despite the absence of a specific statutory provision governing these pipeline purchases. The Court reasoned that pipeline purchases are incidental to transportation and sale which are within the Commission's authority to regulate, and that the pipelines' failure to purchase so as to continue certificated transportation and sale was clearly subject to regulation under the Act. */

*/ Needless to say, regulation of service does not render the production and gathering exemption a nullity. See Shell Brief at 16. State Commissions will
(footnote continued)

B. Under A Service Standard, Costs May Be Taken Into Account, But Profitability To The Producer Cannot Be The Sole Measure Of The Obligation

Beyond the strict legal question of jurisdiction stands the fundamental issue posed by the producers -- whether under the Natural Gas Act, they or the Commission should decide if declines in deliveries, and the resultant impact upon the relying consumer, are justified. Shell Brief at 33. We maintain that the terms, purpose and scheme of the Act lead inexorably to the conclusion that this is a task ultimately committed to the Commission.

In opposing federal regulation of service, the producers advance a number of economic arguments. First, the producers argue at length that the shortage of gas which has plagued the nation throughout much of this decade resulted from the low rates ordered by the Commission. In effect, the producers repeat to this Court the argu-

(footnote continued)
continue to regulate as before. There is no reason to anticipate any conflict between federal and state requirements. If such a conflict should, however, for some reason materialize, it can be dealt with on its specific facts. Sunray Mid-Continent Oil Co. v. FPC, 364 U.S. at 157.

ments they made to Congress in favor of deregulation. The battle over deregulation of new gas, however, is over, and little can be gained by reviewing it. The question here involves old gas, already dedicated to interstate commerce under the Natural Gas Act. Congress chose not to deregulate this category of gas. Moreover, in the NGPA Congress largely preserved the Commission's prior rates with respect to dedicated gas. NGPA § 104(b). The legislature apparently did not agree with the producers that those rates were inadequate. Furthermore, Congress made it clear that consumers should continue to receive this vast quantity of old gas at the rates which were thus preserved. See Council Brief at 18-23.

The producers nevertheless think that regulated rates may prove too low to warrant maintenance of service. However, if these rates are too low, relief is available. The Commission can allow a price higher than the prescribed rate, if it finds a higher price would be just and reasonable within the meaning of the Natural Gas Act. NGPA § 104(b)(2). Alternatively, the Commission could allow a change in service under § 4(d) of the Natural Gas Act, if it found that maintenance of service was not appropriate. Our contention is not that service must be maintained regardless of cost. Our contention is only that the Commission, not the producers must have the final word

as to whether the expense is too great to warrant maintenance of service. Indeed, it is worth noting that every time the Commission grants or denies abandonment of service under § 7(b), it does just that. */ We seek no alteration in these procedures or principles.

To say, however, that costs must be taken into account along with other factors, is not to say that maximization of profit can be the final measure of the supply obligation. See FPC v. Texaco, Inc., 417 U.S. at 398-99. The Commission's duty is to strike a balance between the financial interests of the industry and the needs of the consumer. FPC v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944). The producers ignore this fact. And,

*/ In actual practice, abandonments occur when production is no longer economically feasible, not when the gas is physically depleted. See testimony of the Federal Power Commission in Vol. I, Part 2, of Hearings on the Natural Gas Supply in the United States Before the Subcomm. on Oversight and Investigations of the Comm. on Interstate and Foreign Commerce, 94th Cong., 1st Sess. at 1104 (1975). This Court noted in Permian Basin Area Rate Cases, 390 U.S. at 773, that "only in 'exceptional situations' would the abandonment of unprofitable facilities prove detrimental to consumers, and thus impermissible under § 7(b)."

as discussed above, the prudent operator standard represents no such balance, because ultimate compliance with the standard is determined by reference to what is in the interest of the lessor and lessee.

The producers argue that to maintain service, however, they may have to drill new wells and install new equipment, something they say the Commission cannot order. For support, they claim that the Commission lacks authority to order pipelines to make additional investments, and that to order the producers to do so "expands the Commission's jurisdiction over producers beyond that which it has over pipelines." Shell Brief at 24. Whatever application of the prudent operator standard might require, the service standard advanced by the Council would not contemplate Commission orders directing such investments. Under our standard, as contemplated by § 7(b) and § 4(d) of the Act, the Commission's sole function would be to determine whether a proposed reduction in service was justified by the arguments advanced by the producer.

Nevertheless, in the interest of accuracy, we think it important to note that the Commission very definitely does have authority to order pipelines to make additional investments. See

§ 7(a), 15 U.S.C. § 717f(a). */ Moreover, scores of Supreme Court cases can be found holding that public service corporations, ranging from gas, electric, and telephone companies to railroads, can be required to make capital expenditures necessary "for the rendition of the service to which the [corporation] has committed itself." ICC v. Oregon-Washington Railroad and Navigation Co., 288 U.S. 14, 37 (1932). **/

By focusing heavily on economic questions, the producers have simply highlighted the relationship between price and supply. We fully appreciate the intimate relationship between rates and service, as did Congress in passing the Natural Gas Act. That Act provides for regulation of both, in recognition of the fact that to regulate the one without the other may be an exercise in futility. ***/

*/ The cases cited by the producers (Shell Brief at 24) were decided under a proviso to this section.

**/ In addition to the long list of cases cited in ICC v. Oregon-Washington Railroad and Navigation Co., 288 U.S. at 32 n. 12, see New York ex rel. v. Public Service Commission, 269 U.S. 244 (1925), and New York & Queens Gas Co. v. McCall, 245 U.S. 345 (1917), both dealing with gas companies.

***/ It is noteworthy that the Interstate Commerce Act, as originally passed, (footnote continued)

C. Service Obligations Are Susceptible Of Reasoned Regulation By The Commission

Another theme in the producers' briefs is the contention that gas production is such a mysterious and capricious process that producers' delivery obligations lie beyond the reach of effective regulation. See e.g., Shell Brief at 30. Hence, the producers suggest that the Commission, and consumers who rely upon continued spplies of gas at reasonable rates, must simply trust in the producers.

(footnote continued) provided for regulation of rates alone. Responding to the lower rates which the ICC found to be just and reasonable under the Act, the railroads began substantially to cut back service. To counter the resulting distortion, Congress amended the Act to include a variety of service provisions. This legislation provided the model upon which the Natural Gas Act was closely patterned. For a more thorough discussion of the amendment of the Interstate Commerce Act to include provisions relating to service, see 1 Sharfman, The Interstate Commerce Commission, at 94-103, 177-79, 235-244 (1931).

However, while rates of decline in reservoir production may vary, they are not unpredictable. Thus, in a treatise put out by the Interstate Oil Compact Commission, it is said that:

> "The future performance of wells, tracts, and pools under specified operating conditions may be predicted by a careful analysis of a number of measurements. Forecasts of pressure changes and of the total recoverable oil and gas under different assumed practices can be made with reasonable accuracy. Changes in . . . well productivity, and production rates are quantitatively related to the changes in pressure and are also predictable."

Interstate Oil Compact Commission, Oil and Gas Production at 82 (1969). Moreover, the producers, in providing this Court with a graph of the flow of gas from the typical field, have amply demonstrated that gas production does follow a pattern and thus lends itself to the regulatory oversight we submit the Act requires. Shell Brief at 3.

Finally, regulations can surely be written that take into account a certain range of deviation. The Department of the Interior, in establishing an upper limit on production, has formu-

lated just such a rule. Thus, for example, one order of that department provides: "temporary well production rates resulting from normal variations and fluctuations exceeding a well MPR [maximum production rate] or reservoir MER [maximum efficient rate] shall not be considered a violation of this Order." OCS Order No. 11, May 1, 1974, reproduced in Vol. III of Hearings on the Natural Gas Supply in the United States Before the Subcomm. on Oversight and Investigations of the House Comm. on Interstate and Foreign Commerce, 94th Cong., 2d Sess. at 249 (1976). And, in any event, the Commission is fully capable of determining whether declines in production below the norm are justified for technical or geological reasons.

The essential point, however, is that the questions of service and justification for deviation are matters for the Commission -- not exclusively the producers -- to consider. That is the scheme of the Natural Gas Act, and is central to its basic purpose of protecting the consumer.

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*/ The producers also argue that no delivery obligations can be imposed on them with respect to certificates issued prior to Order 539, because the certificates gave "no hint" of any such obligations. Shell Brief at 31. The short answer to this can be found in Sun Oil Co. v. FPC, 364 U.S. 170 (1960). (footnote continued)

CONCLUSION

In closing, we note that two central themes run through this Court's decisions on the Natural Gas Act. The first theme is the Act's concern for the ultimate consumer, and the need to protect him against unilateral acts of natural gas companies which may frustrate his need for a steady and reliable supply of natural gas. See, e.g., California v. Southland Royalty Co., 98 S. Ct. at 1958; FPC v. Louisiana Power & Light Co., 406 U.S. at 631; Sunray Mid-Continent Oil Co. v. FPC, 364 U.S. at 147; Phillips Petroleum Co. v. Wisconsin, 347 U.S. at 685; FPC v. Hope Natural Gas Co., 320 U.S. at 610. The second theme is a willingness to cut through the conflicting legal arguments and look carefully at the necessary consequences, or practical effects, involved in a proffered reading

(footnote continued)
Whereas in issuing a certificate to Sunray (Sunray Mid-Continent Oil Co., supra) the Commission explicitly stated that the service obligation would be unlimited as to time, in issuing a certificate to Sun Oil, the Commission had made no statement to that effect. This Court found no reason to distinguish the two situations. In construing Sun Oil's service obligation as unlimited, the Commission was not retroactively modifying the previously issued certificate, but simply spelling out the obligations inherent therein.

of the Act. See, e.g., California v. Southland Royalty Co., 98 S. Ct. at 1961; FPC v. Louisiana Power & Light Co., 406 U.S. at 632-34; Permian Basin Area Rate Cases, 390 U.S. at 777; United Gas Improvement Co. v. Continental Oil Co., 381 U.S. 392, 402-03 (1965); Sunray Mid-Continent Oil Co. v. FPC, 364 U.S. at 142-43; Phillips Petroleum Co. v. Wisconsin, 347 U.S. at 685. In keeping with the approach of this Court in the above cited cases, we urge that this matter be remanded to the Commission for further proceedings designed to govern producer delivery obligations in a fashion consistent with the Natural Gas Act's concern for reliable service.

Respectfully submitted,*/

Charles E. Hill

Jane M. Kheel

Attorneys for Petitioner
Consumer Energy Council
of America

*/ Counsel were assisted by George R. Bellack, a third year law student at Georgetown Law Center.